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DE RUEHTA #1702/01 2521052
ZNR UUUUU ZZH
O 081052Z SEP 08
FM AMEMBASSY ASTANA
TO RUEHC/SECSTATE WASHDC IMMEDIATE 3222
INFO RUCNCIS/CIS COLLECTIVE 0628
RUCNCLS/SOUTH AND CENTRAL ASIA COLLECTIVE

UNCLAS SECTION 01 OF 02 ASTANA 001702

SENSITIVE
SIPDIS

E.O. 12958: N/A
TAGS: EPET EINV PGOV KZ
SUBJECT: KAZAKHSTAN - NEW PRESIDENT OF KAZMUNAIGAZ ON NATIONAL OIL COMPANY'S PLANS AND PRIORITIES

SUMMARY

¶1. (SBU) New KazMunaiGas (KMG) head Kairgeldy Kabyldin outlined for the Ambassador his company's strategic priorities in a September 2 meeting. He said that despite the conflict in Georgia, Kazakhstan remained committed to exporting crude through the Caucasus. Kabyldin explained that the Kazakhstan-China oil pipeline is moving forward, and that Kazakhstan's new crude export duty is only having a limited impact on KMG. Kabyldin's comments on CPC pipeline expansion are reported septel. End Summary.

KMG'S STRATEGIC PRIORITIES

¶2. (SBU) New KazMunaiGaz (KMG) head Kairgeldy Kabyldin told the Ambassador on September 2 that he believes President Nazarbayev selected him to replace Serik Berkitbayev because of his technical knowledge of the energy industry, expertise in transportation issues, and more than 30 years of management experience with KMG and with the Samruk state holding company, which is the 100 percent owner of KMG. (Comment: Samruk Board of Directors Chairman Sir Richard Evans told the Ambassador on September 8 that with the appointment of Kabyldin, Samruk has completed the removal of the "old guard" from control of KMG, and is now in a much better position to move the company forward. Samruk President Kanat Bozumbayev was himself just named Chairman of KMG's Board of Directors, and Samruk recently arranged for an independent audit of KMG. End Comment.)

¶3. (SBU) Describing his vision for the future of KMG, Kabyldin emphasized the importance of MangistauMunaiGaz (MMG). KMG has previously announced its intent to purchase 51 percent of MMG's shares, with the remainder likely to be sold to Gazpromneft or Mittal. Kabyldin also stressed the need to conclude negotiations to restructure the management and operatorship of the Kashagan project by October 25. Kabyldin noted that KMG aspires to become an independent or lead operator for major new fields in Kazakhstan, mentioning in particular the N Block, Pearls field (Zhemchuzhina), and Darkhan. Regarding the N Block, Kabyldin said that Conoco-Philips was awarded a small contract to serve as a technical advisor during the initial stages of the project. Kabyldin was also enthusiastic about KMG's downstream investments in Ceyhan, in particular, in refinery operations that will eventually be able to refine up to 100 million tons of crude annually. He also said that KMG plans to double the number of KMG gas service stations in Kazakhstan to 330 by 2012, increasing its domestic market share of retail gasoline sales from 6 percent to 15 percent. He eagerly described KMG's plans to develop petrochemical products, mentioning KMG's investments to upgrade a factory in Atyrau. Kabyldin acknowledged that KMG will have to make significant financial and human capital investments in the near future to conclude these transactions, but he does not anticipate difficulty raising financing for the deals, despite Fitch's recent decision to downgrade the credit rating of KMG Exploration and Production to "BBB-."

NO PLANS TO RETHINK MULTIPLE EXPORT ROUTES

¶4. (SBU) Commenting on the impact of the conflict in Georgia, Kabyldin said that KMG had absolutely no plans to rethink its strategy to develop multiple export routes, including via the Kazakhstan Caspian Transportation System (KCTS) to the Baku-Tbilisi-Ceyhan (BTC) pipeline. Although Kabyldin emphasized the importance of political stability in the Caucasus region to KMG's long-term investment plans, he stressed that exports to the West via the Caucasus route are critically important to KMG's multi-vector export strategy and will remain so in the future. Kabyldin likewise emphasized the importance of using the existing Baku-Supsa pipeline to accommodate current and future oil exports from Kazakhstan. He said that Baku-Supsa has been underutilized for two years, but that KMG and the Georgian government are quite interested in making use of this infrastructure. The Azerbaijanis, however, have not been as eager. Kabyldin explained that oil shipments via the Baku-Supsa pipeline are much cheaper than shipments by rail (transportation via the Baku-Supsa pipeline costs approximately $0.30 per barrel, whereas shipments by rail cost $5.00 per barrel). Kabyldin noted that the current capacity of Baku-Supsa is 6 million tons per year, but could be expanded to 10 million tons per year. As he explained it, "there is no need to build a new pipeline -- we should use this existing one."

CHINA PIPELINES MOVING FORWARD

¶5. (SBU) Kabyldin maintained that final agreement on the Prikaspiskiy gas pipeline from Turkmenistan through Kazakhstan to Russia along the Caspian shoreline has stalled due to disagreements among the parties. Meanwhile, work on gas and oil pipelines to China are moving forward, Kabyldin said. Stroytransgaz, a subsidiary of Gazprom, had previously begun construction of the Turkmenistan section of the Turkmenistan-Uzbekistan-Kazakhstan-China gas pipeline, while Asia Trans Gas, a joint venture of Uzbekneftegas and China's CNPC, started construction of the Uzbek section in June. CNPC and KMG began construction of the Kazakhstan section of this pipeline in July. The Chinese are also financing a Kazakhstan-China oil pipeline to bring crude from Atyrau to Alashankou in China's Xinjiang Uygur Autonomous Region. The final section -- from Keniyak to Kumkol -- is already under construction. The oil pipeline is expected to be completed in October 2009 and to reach full capacity in 2011. It remains to be seen, however, whether the Chinese will be willing to pay competitive market prices and whether Tengizchevroil will receive a better offer for its crude from the Chinese than from Western customs, Kabyldin contended.

LIMITED IMPACT FROM EXPORT DUTY

¶6. (SBU) Kabyldin commented that Kazakhstan's new duty on the export of crude and crude products is having some impact on KMG's revenues, but it will not have a significant impact unless oil falls below $80 per barrel, at which point the tariff will affect credit costs, input costs, and other costs. Kabyldin could not say definitively that the Kashagan project will be exempt from the export duty. He maintained that Karachanak's existing Production Sharing Agreement (PSA) does have a tax stability clause, but it does not explicitly state that production is exempt from export duties.

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